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ZNR UUUUU ZZH
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FM AMEMBASSY ROME
TO RUEHC/SECSTATE WASHDC 2975
RUEATRS/DEPT OF TREASURY WASHDC
RUCPDOC/DEPT OF COMMERCE WASHDC
INFO RUEHSS/OECD POSTS COLLECTIVE

UNCLAS ROME 001340

SENSITIVE
SIPDIS

E.O. 12958: N/A
TAGS: ECON IT
SUBJECT: ITALIAN ECONOMY REMAINS IN LOW GEAR

¶1. (U) Summary -- Italy's central bank and private economists are predicting modest growth in 2010, ranging from 0.4% to 1.0%, but they remain concerned that a stagnant jobs picture may yet tip Italy into a double-dip recession. Italy's already massive public debt prevents any significant stimulus action by the GOI, leaving Italy dependent on the stimulus programs of countries (mainly Germany) that consume Italian exports. The government's focus on short-term performance has all but erased discussion of much-needed longer-term structural economic reform. End Summary

¶2. (U) Italy's economic performance moved briefly to center stage in mid November as positive third quarter GDP figures marked the end, technically, of a recession that began in the second quarter of 2007. The cheery feeling was short-lived, however, as September industrial production figures showed a new steep decline. The third quarter GDP numbers prompted forecasters to adjust their full year 2009 GDP growth estimates to a range between negative 4.4 and negative 4.8 percent. Policy-makers, politicians and most economists Post has consulted recently remain focused on credit and industrial production.

¶3. (SBU) After a brief hiatus, Economics and Finance Minister Giulio Tremonti resumed his public criticism of banks for their alleged refusal to lend to Italian businesses in their hour of need. The Central Bank's October lending survey indeed revealed a not surprising further slowing of credit growth from banks to firms and households. Banks we've spoken with tell us (and the press) that the slowing rate of credit growth (currently around 2.5% annually) is due to a fall in loan demand, a claim the Central Bank's lending survey supports. According to the survey, loan demand by firms was off 20% from 6 months prior. The survey also documents a slight tightening of bank lending conditions for both firms and households.

¶4. (U) The September industrial production decline of 5.3% dealt a harsh blow to recovery expectations. The September data could reflect a backlash to the strong August data, which may reflect overly aggressive rebuilding of inventories. All the same, the September figure chilled expectations for a speedy recovery. Over the weekend of November 28 the research department of Confindustria, the leading employers' association, released its spot report anticipating a 1.6% and 1% increase on industrial production respectively in October and November.

5.(U) At about the same time, consumer confidence surveys that had reflected moderately optimistic Italian households in the Spring (during the depths of the recession) have now turned negative. This is likely due to the lagging effect on income and demand from creeping unemployment. Unemployment remains officially in the 8.5 percent range, but the figure masks significant amounts of man-hours lost to the economy from reduced work-day and unpaid vacation measures employers have resorted to in order to avoid layoffs.

¶6. (SBU) Comment: Italy badly needs a pickup in external demand for its manufacturing sector to avert significantly higher layoffs and the consequent depressing effects on domestic demand. Some policy-makers seem to believe that Italian banks have a duty to sustain Italian firms, but the banks need to look after their own financial health, especially as loan defaults have begun to creep up (from 2.6% in September to 4% in November). Unpleasant international developments such as Dubai World's likely $60 billion default (some Italian exposure there) and possible trouble in the Eurozone sovereign debt market won't help matters. Italy's massive budget deficit and public debt load (both of which were enormous before the recession) have prevented the GOI from launching a significant stimulus effort. This makes Italy something of a stimulus "free-rider," dependent on and benefiting from the stimulus programs of other countries (especially Germany, a heavy consumer of Italian exports). With all eyes on the race between unemployment and recovery, talk of needed structural reform has almost completely disappeared from the press.
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